

## **CALIFORNIA BOARD OF ACCOUNTANCY**

### **INITIAL STATEMENT OF REASONS**

**Hearing Date:** March 22, 2003

**Subject Matter of Proposed Regulations:** Examination, Nonlicensee Owners, Board Inquiries, Commissions – “Officers” and “Directors,” Self-Reporting Requirements, Audit Documentation, Continuing Education, Disciplinary Guidelines.

**Amend Section 6 of Title 16 of the California Code of Regulations.**

**Specific Purpose:**

This proposal would amend Section 6 to continue to provide for a numerical passing score of 75 on the current paper-and-pencil Uniform Certified Public Accountant Examination, and to add a provision indicating that the upcoming computerized Uniform Certified Public Accountant Examination will be in a pass/fail format.

**Factual Basis/Rationale:**

The Uniform Certified Public Accountant Examination is scheduled to become a computerized examination sometime during the first half of 2004. However, since the exact start date for computer-based testing is unknown at this time, it is not possible to specify a conversion date in the regulation. Consequently, in order to provide for a smooth transition, it is necessary to include in this regulation a provision specifying the pass point for the current paper-and-pencil exam and a provision covering the pass/fail format of the new computerized examination.

**Adopt Section 6.1 of Title 16 of the California Code of Regulations.**

**Specific Purpose:**

This proposal would add Section 6.1 to specify general procedures for applicants taking the computerized Uniform Certified Public Accountant Examination. Section 6.1 specifies that applicants are responsible for contacting the National Association of State Boards of Accountancy (NASBA) to schedule testing at an examination test center. Section 6.1 also specifies that applicants shall comply with test center rules and procedures and pay the applicable fees.

**Factual Basis/Rationale:**

The Uniform Certified Public Accountant Examination is scheduled to become a computerized examination sometime during the first half of 2004. The examination will continue to be a national examination. To provide for consistency among states, procedures for this exam have been developed by NASBA in coordination with the

American Institute of Certified Public Accountants (AICPA) and various state boards accountancy. Under these new procedures, NASBA will have a central role in coordinating testing. The California Board of Accountancy's regulations need to be revised to specify these new procedures. The adoption of Section 6.1 is necessary to specify that applicants for the computerized examination will need to contact NASBA to schedule testing, pay the appropriate fees, and comply with test center rules and procedures.

### **Amend Section 7 of Title 16 of the California Code of Regulations.**

#### **Specific Purpose:**

Section 7 provides for partial or "conditional credit" for applicants applying under Business and Professions Code Section 5090(b) who do not pass all four parts of the Uniform Certified Public Accountant Examination in one sitting. This proposal adds subsection (e) to Section 7 to indicate that these applicants may complete the examination in accordance with proposed Section 7.2. (Proposed Section 7.2 addresses examination status during the transition to computer-based testing.)

#### **Factual Basis/Rationale:**

The new computerized examination will be a four-part exam just as is the current paper-and-pencil examination. However, the requirements for obtaining partial credit will be different. The requirements for partial credit are specified in proposed Section 7.1 and transition requirements are specified in proposed Section 7.2.

This amendment of Section 7 is necessary to clarify that applicants applying under Business and Professions Code Section 5090(b) may complete the examination under the transition provisions in proposed Section 7.2. Applicants applying under Business and Professions Code Section 5090(b) are the only applicants that have conditional credit requirements specified in Section 7. All other applicants have conditional credit requirements specified in Business and Professions Code Section 5092 or 5093.

### **Adopt Section 7.1 of Title 16 of the California Code of Regulations.**

#### **Specific Purpose:**

This proposal would add Section 7.1 to establish exam passage standards and requirements for the computerized Uniform Certified Public Accountant Examination. Subsection (a) specifies exam passage requirements and the time periods during which credit for passed parts of the four-part examination will be retained. Subsection (b) permits applicants to retain credit for passed sections for an 18-month period. Subsection (c) provides an exception for first-time applicants who sit during the first six months of computerized testing. These applicants would be allowed to retain credit for passed sections for a 24-month period as an incentive to encourage applicants to test. Subsection (d) specifies an applicant may sit for any unpassed section only one time

during a testing window and provides a definition of testing window. Subsection (e) provides for the extension of credit under specified circumstances.

**Factual Basis/Rationale:**

The new computerized Uniform Certified Public Accountant Examination will be a four-part exam just as is the current paper-and-pencil examination. However, the requirements for obtaining partial credit will be different. These new requirements reflect a consensus developed by state boards of accountancy with an interest in maintaining uniform examination passage standards nationwide. It is necessary to adopt subsections (a), (b), and (d) of Section 7.1 in order to specify in regulation these new exam passage standards and provisions for retaining credit for passed sections.

Adoption of subsection (c) is necessary to create an incentive to encourage applicants to sit for the exam during the first six-months of computerized testing so that their test responses can be used to fine tune exam grading procedures. Unfortunately, while this essential fine-tuning process is occurring, the issuance of examination grades may be significantly delayed. This could inconvenience applicants who need to know what parts they have passed before they can schedule to retake unpassed parts. To address this concern and create an incentive for new applicants to test, the Board, in consultation with a representative of NASBA, decided to allow first-time applicants to retain credit for exam sections passed during the first six months of computerized testing for a 24-month period, rather than the 18-month period that will later be standard.

Adoption of this subsection (e) is necessary to clarify the requirements for obtaining extensions for applicants.

**Adopt Section 7.2 of Title 16 of the California Code of Regulations.**

**Specific Purpose:**

This proposal would add Section 7.2 to provide for the transition to the computerized Certified Public Accountant Examination by specifying how applicants can retain credit for the sections of the paper-and-pencil examination they have passed and how they can complete passage of the examination under computer-based testing. Subsection (a) addresses time periods and opportunities to test. Subsection (b) specifies the computer-based equivalent of the sections of the paper-and-pencil exam. Subsection (c) provides for retention of credit on the computerized exam in the event the applicant fails to pass the entire examination under subsection (a).

**Factual Basis/Rationale:**

Adoption of Section 7.2 is necessary to provide transition rules for conversion to computer-based testing. When the Uniform Certified Public Accountant Examination converts from a paper-and-pencil examination to a computer-based examination in

2004, there will be many applicants who have credit for sections of the paper-and-pencil examination they have already passed. Transition rules are needed to ensure applicants are tested in all relevant areas of knowledge, appropriately retain credit for exam sections passed, and are treated equitably.

Subsection (a) specifies the basic transition rule which gives transition applicants an 18-month period in which to complete the exam. During that 18-month period, each applicant will have the same number of opportunities to test as the applicant would have had if paper-and-pencil testing had continued. The Board concluded that this approach treats all applicants equitably, and confines the transition period to a manageable time frame.

The computer-based examination will be organized in different sections than the current paper-and-pencil exam. To provide for transition, it is necessary to specify the computer-based equivalents of each of the sections of the paper-and-pencil examination. The equivalencies specified in subsection (b) reflect a national consensus among state boards of accountancy, NASBA, and the AICPA.

Subsection (c) is necessary to clarify how an applicant will retain credit for the computerized exam sections passed by the applicant in the event the applicant does not pass the entire exam during the transition.

### **Amend Section 8 of Title 16 of the California Code of Regulations.**

#### **Specific Purpose:**

This proposal would amend Section 8 to clarify that the final filing dates specified in this section only apply to the paper and pencil Uniform Certified Public Accountant Examination.

#### **Factual Basis/Rationale:**

Amendment of Section 8 is necessary to clarify that the deadlines specified in this section only apply to the paper-and-pencil Uniform Certified Public Accountant Examination and not to the computerized exam which will have no final filing dates.

### **Adopt Section 8.1 of Title 16 of the California Code of Regulations**

#### **Specific Purpose:**

This proposal would add Section 8.1 to provide for issuance, use, and expiration of the Authorization to Test by the Board and issuance of the Notice to Schedule by NASBA. The Authorization to Test and the Notice to Schedule enable the applicant to schedule and take the computerized Uniform Certified Public Accountant Examination. Subsection (a) provides for the issuance of the Authorization to Test and the time frame

during which this authorization is valid prior to issuance of the Notice to Schedule. Subsection (a) also addresses issuance of the Notice to Schedule. Subsection (b) specifies the purpose of the Notice to Schedule and the time frames and circumstances during which the Notice to Schedule and Authorization to Test remain open. Subsection (c) specifies that if an applicant does not pass a specified section of the exam, the applicant must obtain a new Authorization to Test. Subsection (d) allows the Board to revoke the Authorization to Test under specified circumstances.

#### **Factual Basis/Rationale:**

With commencement of computerized testing, examination administration procedures will change significantly. Adoption of Section 8.1 is necessary to specify in regulation the procedures for applicants to qualify for and schedule to take the computerized Uniform Certified Public Accountant Examination. These procedures and time frames were designed by NASBA to achieve national uniformity and consistency in exam administration and to facilitate coordination with Prometric test centers.

Should there be any problems associated with the applicant, subsection (d) of proposed Section 8.1 allows the Board to suspend the Authorization to Test.

#### **Adopt Section 8.2 of Title 16 of the California Code of Regulations.**

##### **Specific Purpose:**

This proposal would adopt Section 8.2 to specify requirements for issuance of the Authorization to Test which permits the applicant to take the unpassed sections of the computerized Uniform Certified Public Accountant Examination requested by the applicant. Subsection (a) requires applicants to submit completed applications and requires first-time applicants to submit transcripts and/or evaluations of foreign education. Subsection (b) specifies that applicants may not have more than one open Authorization to Test at the same time. Subsection (c) prohibits a applicant from re-taking a section of the examination already passed by the applicant with specified exceptions. Subsection (d) requires the applicant to certify compliance with subsection (b) and (c) at the time of making application for the Authorization to Test. Subsection (e) prohibits licensees from retaking the examination and makes an exception for licensees re-taking the exam pursuant to a disciplinary action.

#### **Factual Basis/Rationale:**

Adoption of Section 8.2 is necessary to provide for issuance of the Authorization to Test and to put in place restrictions on its issuance to provide for the security and integrity of the examination. Subsection (a) is necessary to specify basic application requirements. Subsections (b), (c), (d), and (e) are necessary to restrict the activities of “professional cheaters” and others who take the examination primarily to become acquainted with exam questions and communicate this information to others. The exceptions in

subsections (c) and (e) are necessary for consistency with other Board requirements and regulations.

### **Adopt Section 51.1 of Title 16 of the California Code of Regulations.**

#### **Specific Purpose:**

This proposal would adopt Section 51.1 to specify in regulation how firms must notify clients that the firm has a nonlicensee owner or owners. Subsection (a) indicates acceptable methods of notification. Subsection (b) requires the firm to retain a record of this notification for a five-year period.

#### **Factual Basis/Rationale:**

Adoption of Section 51.1 is necessary in order to provide guidance to licensees regarding how to comply with the newly enacted statutory requirement that licensed firms disclose the actual or potential involvement of nonlicensee owners in the services provided. (See paragraph (5) of subdivision (a) of Business and Professions Code Section 5079 as amended by AB 270, Chapter 231, Statutes of 2002 – Attachment 1.)

### **Amend Section 52.1 of Title 16 of the California Code of Regulations.**

#### **Specific Purpose:**

This proposal amends Section 52 to provide for licensees to respond both to Board inquiries and to subpoenas issued by the Board or its appointed representatives. Amended Section 52 also requires licensees to appear in person upon written notice or subpoena issued by the Board or its appointed representatives. Further, amended Section 52 requires licensees to provide true and accurate information in response to Board inquiries and to not obstruct any Board inquiry, investigation, hearing, or proceeding.

#### **Factual Basis/Rationale:**

Revision of Section 52 is necessary to include in regulation provisions on response to subpoenas now that newly enacted Section 5109 gives the Board the authority to issue subpoenas. (See Business and Professions Code Section 5108 in SB 1955, Chapter 1150, Statutes of 2002 – Attachment 2.) This proposal also incorporates relevant provisions of current Section 52.1 so that Section 52.1 can be repealed.

### **Repeal Section 52.1 of Title 16 of the California Code of Regulations.**

#### **Specific Purpose:**

This proposal would repeal Section 52.1 on Failure to Appear.

**Factual Basis/Rationale:**

Repeal of Section 52.1 is necessary because relevant provisions have been incorporated into newly amended Section 52. Other provisions not incorporated into Section 52 are no longer needed. For example, the reference to failure to appear being a violation of Business and Professions Code Section 5100 (f) is unnecessary as subdivision (f) of Section 5100 provides that willful violation of any Board rule or regulation is unprofessional conduct. Also, the provision on travel and meeting dates is outdated and no longer relevant to current Board operations.

**Adopt Section 56.4 of Title 16 of the California Code of Regulations.****Specific Purpose:**

This proposal would clarify that the terms “officer” and “director” as used in Business and Professions Code Section 5061(c) do not include the officer or director of a nonprofit corporation or a corporation that has 100 or fewer employees or average annual gross receipts of \$10 million or less. A definition of “average annual gross receipts” is provided.

**Factual Basis/Rationale:**

Senate Bill 1955 (Chapter 1150, Statutes of 2002 – Attachment 2) amended subdivision (c) of Section 5061 to broaden the class of persons who are included in the prohibition against taking commissions. The revised prohibition includes not only the client receiving attest services, but also the officers and directors of the client and any client sponsored retirement plan. The statute also provides an exception to the ban on commissions in those instances in which the products or services provided by the CPA firm are provided to the officers and directors of a nonprofit corporation or a corporation that meets the small business workforce or annual receipts standards of Section 1896 of Title 2 of the California Code of Regulations.

Section 1896 has several provisions which apply to different types of businesses (i.e. manufacturing and public works contractors) and which define a small business as one with either 100 or fewer employees or \$10,000,000 or less in average annual gross receipts. However, it is not clear that Section 1896 covers all types of businesses that might have officers or directors for whom CPA firms may provide products or services generating commissions. Also Section 1896 of Title 2 is not part of the regulations normally referenced by the Board’s licensee. Because of this, licensees may find this provision both confusing and difficult to locate.

To address this concern, Section 56.4 would add key provisions of Section 1896 to the Board’s regulations. Adoption of Section 56.4 is necessary to clarify the provision for the Board’s licensees and prevent confusion.

## **Adopt Section 59 of Title 16 of the California Code of Regulations.**

### **Specific Purpose:**

This proposal would add Section 59 to the Board's regulations to clarify requirements for the self-reporting of restatements issued by licensees. This self-reporting requirement was added by amendments to Business and Professions Code Section 5063 (AB 270, Chapter 231, Statutes of 2002 – Attachment 1). Subsection (a) of proposed Section 59 indicates that the restatements to be reported are restatements issued to correct an error in a previously issued financial statement for a client that is a public company or other entity doing business in California, a charity registered in California, or a California government agency. Subsection (b) clarifies who should report and the information the report should include. All information to be reported in compliance with Section 59 is information that is publicly disclosed.

### **Factual Basis/Rationale**

Business and Professions Code Section 5063 was amended to require the self-reporting of "any restatement of a financial statement and related disclosures by a client audited by the licensee." Amendments also authorize the Board to adopt regulations to further define reporting requirements.

A regulation is needed to further define this reporting requirement so that the information that is reported is most likely to be useful to the Board in carrying out its mandate to protect California's consumers. If licensees are required to report all restatements including restatements issued because of changes in accounting standards, this could result in a large volume of reported information with only a small portion that would be useful to the Board. Such a broad, unfocused reporting requirement could be confusing and inconvenient for licensees and administratively burdensome for the Board's Enforcement Program, without bringing about enhanced consumer protection.

In an effort to better define this and other reporting requirements, the Board organized its Reform Statutes Implementation Task Force which held a full-day meeting on October 31, 2002. Members of the public and representatives of the profession participated in the meeting of the Task Force and the subsequent Board meeting (see Attachment 3 for excerpts from minutes). After discussion of this matter, it was concluded that the most useful information would come from the reporting of restatements issued to correct errors in previously issued financial statements. Since "error" is a term-of-art, it is anticipated that this requirement will be well understood by licensees (see Attachment 4).

The Board also decided that the regulation should only require the reporting of information that is publicly disclosed. This information is likely to have the broadest impact on the public, and therefore tie most directly to the Board's consumer protection



mandate. This decision also addresses privacy and confidentiality concerns that could arise if licensees were required to report restatements of financial statements for private businesses or individuals, or to report on donors for charities.

In addition, it was concluded that, since the Board's mandate is to protect California consumers, licensees should be required to report restated financial statements when the client is a public company or other entity doing business in California, a charity registered in California, or a California government agency.

For enhanced clarity, subsection (b) of Section 59 indicates the licensee issuing the restatement should report to the Board because that licensee would be most knowledgeable about the matter, even if another licensee performed the original audit.

### **Adopt Section 60 of Title 16 of the California Code of Regulations.**

#### **Specific Purpose:**

This proposal would adopt Section 60 to define in regulation “notice of the opening or initiation of an investigation by the Public Company Accounting Oversight Board” in accordance with newly amended Business and Professions Code Section 5063 (AB 270 Chapter 231, Statutes of 2002 – Attachment 1). Section 60 also defines “associated person” using the same definition as the Sarbanes-Oxley Act of 2002.

#### **Factual Basis/Rationale:**

Newly amended Business and Professions Code Section 5063 requires licensees to self-report receipt of a notice of the opening of an investigation by the Public Company Accounting Oversight Board and requires the Board to further define this phrase in a regulation. Proposed Section 60 provides this additional definition and clarification in regulation.

### **Adopt Section 61 of Title 16 of the California Code of Regulations.**

#### **Specific Purpose:**

This proposal adopts Section 61 to further define reporting requirements with regard to settlements, arbitration awards, and judgments. With regard to settlements and arbitration awards, this proposal requires reporting when the award is the result of actions brought by persons located, residing, or doing business in California. With regard to judgments, Section 61 would limit the reporting of judgments alleging negligent conduct to those judgments in which a person residing or doing business in California is a party to the action or where the alleged conduct relates to the practice of public accountancy in California.

**Factual Basis/Rationale:**

The Board's Reform Statutes Implementation Task Force reviewed amendments to Business and Professions Code Section 5063 (enacted by AB 270, Chapter 231, statutes of 2002) related to the reporting of civil action settlements and arbitration awards. The objective was to determine how best to further define this reporting requirement so that the information that is reported is most likely to be useful to the Board in carrying out its consumer protection mandate. The Task Force and later the full Board concluded that, since the Board's mandate is to protect California consumers, it would be appropriate to define this reporting requirement by requiring licensees to report settlements and arbitration awards that are the result of actions brought by persons located, residing, or doing business in California.

The Board's Reform Statutes Implementation Task Force and later the full Board also reviewed newly enacted subdivision (c) of Section 5063 related to the reporting of civil judgments. The Board concluded that, to best protect consumers, judgments alleging any of the types of conduct listed in subdivision (c) should be reported even if the conduct occurs outside of California with the exception of judgments alleging simple negligence. Because simple negligence is less egregious than the other types of conduct listed in subdivision (c) and the volume of judgments alleging negligence is likely to be great, the Board determined it would be consistent with its consumer protection mandate to only require the reporting of judgments alleging negligent conduct in those instances in which a person residing in or doing business in California is a party to the action or where the alleged conduct relates to the practice of public accountancy in California.

**Adopt Section 68.2 of Title 16 of the California Code of Regulations.****Specific Purpose:**

This proposal would adopt Section 68.2 to specify in regulation the components and identification of audit documentation. Subsection (a) parallels language in the General Accounting Office's (GAO's) Government Auditing Standards (see Attachment 5). Subsection (a) also includes relevant portions of newly enacted Business and Professions Code Section 5097. Subsection (b) addresses the identification of audit documentation.

**Factual Basis/Rationale:**

Newly enacted Business and Professions Code Section 5097 establishes audit documentation requirements for licensees and Section 5098 authorizes the Board to adopt regulations related to procedures for the identification, dating, and retention of audit documentation (AB 2873, Chapter 230, Statutes of 2002 – see Attachment 6). Adoption of Section 68.2 is necessary in order to specify these procedures in the Board's regulations.

Proposed Section 68.2 and other rules related to audit documentation were considered in meetings of the Board's Reform Statutes Implementation Task Force and the full Board. Since a provision of the GAO Yellow Book formed the basis for subdivision (c) of Section 5097, it was deemed to be an appropriate model for subsection (a) of Section 68.2 as well. Even though the language in proposed Section 68.2 is somewhat duplicative of the statutory provision, it was deemed appropriate to repeat this language in proposed Section 68.2 for enhanced clarity. Proposed Subsection (b) was developed based on the Board's experience in disciplinary matters.

### **Adopt Section 68.3 of Title 16 of the California Code of Regulations.**

#### **Specific Purpose:**

This proposal would adopt Section 68.3 to specify retention periods and requirements for audit documentation. Subsection (a) specifies the start time for the retention period specified by Business and Professions Code Section 5097. Subsection (b) specifies when records may be destroyed in the event the records must be maintained longer than seven years because of a pending Board investigation. Subsection (c) provides a general requirement that records must be retained in a form that is accessible.

#### **Factual Basis/Rationale:**

Subdivisions (d) and (e) of Business and Professions Code Section 5097 provide for the retention of audit documentation. A regulation is necessary to clarify and make specific the requirements of these subdivisions.

This matter was considered in meetings of the Board's Reform Statutes Implementation Task Force and the full Board. Proposed Section 68.3 is the result of those discussions. The report date was selected as a readily accessible date for commencement of the audit documentation period – subsection (a) of proposed Section 68.3. Subsection (b) clarifies retention requirements in the event of a pending Board investigation. Subsection (c) addresses the concern that records may exist but not be accessible, for example electronic records may exist but not be accessible because of changes in computer software.

### **Adopt Section 68.4 of Title 16 of the California Code of Regulations.**

#### **Specific Purpose:**

This proposal would adopt Section 68.3 to define and specify requirements for changes in audit documentation. Subsection (a) provide a definition of audit documentation. Subsection (b) establishes dating requirements. Subsection (c) addresses the identification of persons making the change and dating of the change. Subsection (c) also requires that documentation of changes contain sufficient detail to enable a reviewer with relevant knowledge and experience, having no previous connection with

the audit engagement to understand the nature, timing, reason for, and extent of the change.

**Factual Basis/Rationale:**

Business and Professions Code Section 5097 (AB 2873, Chapter 230, Statutes of 2002 – Attachment 6) establishes audit documentation requirements and Section 5098 authorizes the Board to adopt regulations related to procedures “for the identification, dating, and retention of audit documentation” (AB 2873, Chapter 230, Statutes of 2002). Adoption of Section 68.4 is necessary to specify in regulation procedures for identifying and dating changes in audit documentation.

This matter was considered in meetings of the Board’s Reform Statutes Implementation Task Force and the full Board. Proposed Section 68.4 is a result of those discussions. After discussion, the Board concluded that it is necessary to specify requirements for changes in audit documentation as such changes are sometimes an issue in disciplinary matters. Subsection (a) defines changes in audit documentation and indicates this definition applies to changes made after the date of issuance of the audit report. Subsection (b) requires that the date of issuance be documented as this is not required by professional standards. Subsection (c) establishes the same standard for changes in audit documentation as Section 68.2 and subdivision (b) of Business and Professions Code Section 5097 establishes for audit documentation in general. Even though the language in proposed Section 68.4 is somewhat duplicative of the statutory provision it implements, it was deemed appropriate to repeat this language in proposed Section 68.4 for enhanced clarity.

**Adopt Section 68.5 of Title 16 of the California Code of Regulations.**

**Specific Purpose:**

This proposal would adopt Section 68.5 to specify requirements for audit documentation and destruction policies. Subsection (a) establishes the general requirement for this policy. Subsection (b) specifies the components of the policy including procedures for maintaining back-up copies of electronic documentation, procedures for documentation maintenance, procedures for approving changes in documentation, and documentation destruction procedures. Subsection (c) specifies additional documentation destruction requirements including the requirement that, at the time of document destruction, an authorized person verify compliance with subdivisions (d) and (e) of Business and Profession Code Section 5097.

**Factual Basis/Rationale:**

Business and Professions Code Section 5098 (AB 2873, Chapter 230, Statutes of 2002) authorizes the Board to adopt a regulation to require that licensees maintain audit documentation retention and destruction policies.

This matter was considered in meetings of the Board's Reform Statutes Implementation Task Force and the full Board. Proposed Section 68.5 reflects the result of those discussions and the Board's conclusion that audit documentation retention and destruction policies are essential to ensure the safeguarding of audit documentation. Section 68.5 specifies the minimum required components of the policy to help ensure critical documents are retained, while at the same time giving licensees flexibility to develop policies appropriate for their firms and practices. Section 68.5 includes provisions related to documenting and verifying compliance and making the policy and documentation of compliance available to the Board upon request. These provisions are intended to assist the Board in its oversight activities.

### **Amend Section 70 of Title 16 of the California Code of Regulations.**

#### **Specific Purpose:**

This proposal would amend Section 70 related to fees to incorporate fee changes related to the Uniform Certified Public Accountant Examination which is scheduled to be computerized in 2004. Amendments specify a fee of \$100 for first-time applicants and \$50 for repeat applicants for issuance of the Authorization to Test for the computerized examination. Amendments also reduce the fee for each part of the paper-and-pencil examination to \$36. In addition, amendments to Section 70 delete outdated provisions that no longer apply.

#### **Factual Basis/Rationale:**

It is anticipated that the Uniform Certified Public Accountant Examination will be computerized commencing in 2004. Currently, the Board reviews applicants' qualifications and administers the exam to qualified applicants. With commencement of computerized testing, the Board will evaluate the applicants' qualifications and then refer qualified applicants to NASBA to coordinate testing. Revisions to Section 70 are necessary to provide for the fees for this new procedure. Additional revisions to Section 70 are necessary to delete outdated provisions for enhanced clarity.

### **Amend Section 71 of Title 16 of the California Code of Regulations.**

#### **Specific Purpose:**

This proposal would amend Section 71 to address application processing changes which will occur when the Uniform Certified Accountant Examination is computerized in 2004. Amendments to subsection (a) indicate that the subsection applies to the current paper-and-pencil examination. Amendments to subsection (a) also delete the reference to Section 6 of these regulations.

New subsection (b) adds a provision related to abandonment of the Authorization to Test for the computerized Uniform Certified Public Accountant Examination pursuant to proposed Section 8.1.

**Factual Basis/Rationale:**

It is anticipated that the Uniform Certified Public Accountant Examination will be computerized commencing in 2004. Amendment of Section 71 is necessary to add a provision specific to abandonment of the application for the Authorization to Test for the computerized examination and to clarify that the existing provision on abandonment of the application for the examination applies to applications for the paper-and-pencil exam. Further, it is necessary to delete the reference to Rule 6 because Section 6 has been amended and it no longer contains the provision that is referenced in current Section 71.

**Amend Section 88 of Title 16 of the California Code of Regulations.****Specific Purpose:**

This proposal would amend Section 88 to add a definition of “formal program of learning” and to clarify that correspondence programs must be based upon materials specifically developed for instructional use. This proposal would also clarify that self-study modules for national examinations such as Certified Financial Planner or Certified Management Accountant qualify as acceptable continuing education provided they meet the other requirements specified in Section 88.

**Factual Basis/Rationale:**

Licensees have expressed confusion regarding the meaning of the phrase “formal program of learning.” They have also expressed confusion regarding which courses are acceptable correspondence courses. For example, licensees have asked whether self-study modules for national examinations qualify as acceptable continuing education. Amendments to Section 88 are necessary to address these concerns. Proposed amendments clarify the meaning of “formal program of learning” and clarify which correspondence or individual study programs are acceptable continuing education. Amendments also indicate that self-study modules for relevant national examinations are acceptable continuing education provided they meet the other requirements specified in Section 88.

**Amend Section 88.2 of Title 16 of the California Code of Regulations.****Specific Purpose:**

This proposal would add new subsection (c) to Section 88.2 to specify new self-study continuing education requirements commencing January 1, 2004. The new self-study requirements will grant continuing education credit equal to the average completion time for all self-study courses and require that courses employ significant ongoing interactive feedback simulating classroom learning. The new requirements will continue to require that the course meet the provider requirements for self-study courses specified in

Section 88.1 and that a test be given at the conclusion of the course which the licensee must pass to receive continuing education credit.

**Factual Basis/Rationale:**

NASBA and the AICPA have jointly issued a new Statement of Standards for Continuing Professional Education Programs (Attachment 7). These new standards constitute a national model for accountancy continuing education programs. With regard to self-study continuing education programs, the new Statement on Standards eliminates the distinction between interactive and noninteractive self-study and requires that all self-study courses be designed in an interactive format (regardless of whether the course is technology-based or not). This standard also grants credit based on the average completion time for all self-study courses. As part of this change, effective in 2004, continuing education providers that are registered with NASBA will issue certificates of completion consistent with the new standard.

Current Section 88.2 is inconsistent with the new standard. It indicates a distinction between interactive and non-interactive self-study and mandates that interactive self-study courses be technology-based. Also, current Section 88.2 grants continuing education credit equal to the average completion time for interactive self-study, but grants credit equal to one-half the average completion time for all other self-study courses. These differences are likely to be confusing to licensees and difficult to administer. Amendments to Section 88.2 are necessary to prevent confusion and to achieve consistency with the new national standard.

**Amend Section 98 of Title 16 of the California Code of Regulations.**

**Specific Purpose:**

This proposal would amend Section 98 to incorporate by reference the 2003 edition of the California Board of Accountancy's "A Manual of Disciplinary Guidelines and Model Disciplinary Orders" (see Attachment 8).

**Factual Basis/Rationale:**

Government Code Section 11425.50(e) states that penalties cannot be based on a guideline unless the guideline is adopted as a regulation. In conformance with that requirement, current Section 98 incorporates by reference the California Board of Accountancy's "A Manual of Disciplinary Guidelines and Model Disciplinary Orders" (4<sup>th</sup> edition, 2000).

Business and Professions Code Section 5100 which provides grounds for discipline was recently amended and re-lettered (see AB 270 and AB 2873, Chapters 231 and 230, Statutes of 2002 – Attachments 1 and 6). The Board's Disciplinary Guidelines have been revised to reflect this change. Amendments to Section 98 are necessary to incorporate by reference these updated disciplinary guidelines.

THE FOLLOWING APPLY TO THE PROPOSAL AS A WHOLE:

**Underlying Data:**

See the attachments referenced earlier in this document.

**Business Impact:**

This regulation will not have a significant adverse economic impact on businesses. This initial determination is based on the following facts or evidence/documents/testimony:

The proposed adoption of Sections 7.1, 7.2, 8.1, and 8.2 and amendment of Sections 6, 7, 8, 70, and 71 affect applicants for the examination and do not impact businesses.

The proposed adoption of Section 51.1 clarifies the statutory requirement that firms notify clients that nonlicensees owners may be providing services. Proposed Section 51.1 does not impose any new requirements. This proposal was discussed at a meeting of the Board's Reform Statutes Implementation Task Force and at a meeting of the full Board. None of the participants at those meeting expressed concern that this regulation would have a significant adverse economic impact on businesses. (See Attachment 3 for excerpts from the minutes of those meetings.)

The proposed amendment of Section 52 and repeal Section 52.1 updates these regulations to include provisions related to response to subpoenas. Further, the repeal of Section 52.1 removes outdated provisions. This is intended to clarify and update requirements, but not impose any additional requirements. This proposal was discussed at a meeting of the Board's Reform Statutes Implementation Task Force and at a meeting of the full Board. None of the participants at those meeting expressed concern that this regulation would have a significant adverse economic impact on businesses. (See Attachment 3 for excerpts from the minutes of those meetings.)

The adoption of Section 56.4 is intended solely to clarify statutory amendments and to simplify compliance. It does not impose any new requirements.

The adoption of Sections 59, 60, and 61 clarify and define the self-reporting requirements mandated by amendments to Business and Professions Code Section 5063 (AB 270, Chapter 231, Statutes of 2002 – Attachment 1). This proposal was discussed at a meeting of the Board's Reform Statutes Implementation Task Force and at a meeting of the full Board. None of the participants at those meeting expressed concern that these regulations would have a significant adverse economic impact on businesses.

The adoption of Sections 68.2, 68.3, 68.4, and 68.5 implement newly enacted Business and Professions Code Sections 5097 and 5098 by specifying requirements for the components of audit documentation, retention periods, changes in documentation, and



retention/destruction policies. This proposal was discussed at a meeting of the Board's Reform Statutes Implementation Task Force and at a meeting of the full Board. None of the participants at those meeting expressed concern that these regulations would have a significant adverse economic impact on businesses. (See Attachment 3 for excerpts from the minutes of those meetings.)

Proposed amendments to Sections 88 and 88.2 revise the requirements for self-study continuing education to be more consistent with updated national standards, but do not mandate any additional continuing education.

Proposed amendments to Section 98 merely incorporates by reference the Board's newly revised disciplinary guidelines. There are no new requirements for licensed individuals or firms.

### **Specific Technologies or Equipment:**

This regulation does not mandate the use of specific technologies or equipment.

### **Consideration of Alternatives:**

No reasonable alternative to these regulations would be either more effective in carrying out the purpose for which the action is proposed or would be as effective and less burdensome to affected private persons than the proposed regulations.

Set forth below are the alternatives which were considered and the reasons each alternative was rejected:

- The following alternative to Section 6.1 was considered by the Board:

#### Section 6.1. Additional Requirements for Computer-Based Testing.

Upon the commencement of computer-based testing in California, applicants are responsible for contacting the National Association of State Boards of Accountancy to obtain a Notice to Schedule and the examination test centers to obtain a date to examine, in accordance with instructions provided by the Board. Applicants shall pay all required fees and comply with test center procedures and rules.

This alternative was rejected because the proposed language has greater clarity.

- The Reform Statutes Implementation Task Force considered the following alternative language for subsection (b) of Section 51:

(b) A copy of the statement, contract, or engagement letter containing this notice shall be maintained in the client's files for a minimum of five years from the date of the notice.

This language was rejected in favor of language which clarifies that the public accounting firm would be responsible for maintaining a copy of the notice.

The following alternative language for Subsection (b) was then proposed by the Task Force and considered by the Board:

(b) A copy of the statement, contract, or engagement letter containing this notice shall be maintained by the public accounting firm in the client's files for a minimum of five years from the date of the notice.

This language was rejected in favor of language that also listed "proposal letter" as one of the documents to be maintained. This provides for greater consistency with proposed subsection (a)(2).

- The Reform Statutes Implementation Task Force considered the following alternative language for proposed Section 52:

~~52. Response to Board Inquiry.~~ Response to Board Subpoena, Inquiry, Investigation or Request for Information.

~~A licensee shall respond to any inquiry by the Board or its appointed representatives. The response shall include making available all files, working papers and other documents requested. Failure to respond to the inquiry within 30 days constitutes a violation of Section 5100(f) of the Accountancy Act. Any inquiry by the Board requiring a response pursuant to this section shall be in writing. The 30-day response period begins when the inquiry is mailed to the licensee, or if not mailed, when personally delivered.~~

(a) A licensee shall respond to any subpoena, inquiry, investigation, or request for information, documents, the personal appearance of the licensee, or testimony by the licensee issued by or on behalf of the Board or its authorized representatives regarding any matter within the Board's powers or jurisdiction under Section 5103 of the Business and Professions Code or any other applicable law.

(b) The response to the subpoena, inquiry, or request shall be produced at the time and place specified in the subpoena, inquiry, or request. The response made by the licensee shall include making available all files, working papers and other documents requested, and shall state, if necessary, the reason(s) why the licensee is not fully responding to the Board inquiry. Copies of records may be substituted for original records at the discretion of the Board.

(c) A licensee shall not be excused from responding to a Board inquiry, including responding to a Board subpoena, except as provided in this subsection:

(1) Any claim of privilege or other reason for failure to fully respond to written requests for information or written questions shall be in writing and shall include the privilege claimed or other reasons the information is not being provided in whole or part and the constitutional or statutory provision supporting the privilege or the failure to fully respond to the written request or question.

(2) Any documents which are not produced based on a claim of privilege or for any other reason, shall be identified in writing by author and date, the privilege claimed, or other reasons for not producing the documents, and any constitutional or statutory provision supporting the privilege or the failure to produce the documentation.

(3) Claims of privilege to oral questions or inquiries must be made at the time and place of the specific question or inquiry and shall include the privilege claimed and any constitutional or statutory provision supporting the privilege. Documents subpoenaed or noticed to be produced at the time and place of the licensee's testimony which are not produced shall meet the requirements of paragraph (2) of this subsection.

(d) In complying with the requirements of subsections (a), (b), or (c) of this section, a licensee shall not make false or misleading statements or provide altered or incomplete records.

(e) Failure of a licensee to comply with the provisions of this section is unprofessional conduct under Business and Professions Code Section 5100.

This alternative language was rejected by the Task Force and not recommended to the Board because the Task Force concluded the language was unnecessarily complex and could be confusing to licensees.

- The following alternative language for Section 59 was considered by the Reform Statute Implementation Task Force.

#### Section 59. Reporting of Restatements.

(a) To comply with the requirements of paragraph (1) of subdivision (b) of Business and Professions Code Section 5063, licensees are required to report to the Board the following:

(1) Any restatement of a financial statement of a client incorporated, located, or doing business in California audited by the licensee which is issued for purposes of correcting any error in a previously issued financial statement and which is publicly disclosed by the client or available for inspection by the public upon request.

(2) Any restatement of a financial statement of a charitable organization registered by the Office of the Attorney General's Registry of Charitable Trusts audited by the licensee which is issued for purposes of correcting any error in a previously issued financial statement and which has resulted in the filing of an amended or superceding Internal Revenue Service Form 990 of 990PF.

(b) The report shall be provided to the Board within 30 days of issuance of the restatement and shall include an explanation of the reason for the restatement. The report made under paragraph (a)(1) of this section shall include copies of the original and restated financial statement. The report made under paragraph (a)(2) of this section shall include the original and amended Form 990 or 990PF.

The language in the introductory paragraph of subsection (a) of this alternative was rejected because it fails to clearly indicate who is required to report. The language in subsection (b) of this alternative was rejected because it lacked clarity regarding who is to report in those instances in which the licensee issuing the restatement did not issue the original audit report. It also lacked clarity regarding what information should be reported when the client is a charity. The Task Force modified the language for these provisions and recommended revised language that was approved by the Board with minor edits.

The Task Force recommended to the Board two alternatives for paragraph (1) of subsection (a) of Section 59. This proposal provides the language preferred by the Board. The following alternative was not approved by the Board:

(1) Any restatement of a financial statement issued either for the purpose of correcting any error in a previously issued financial statement or for any other purpose that does not involve a restatement required solely by newly issued or revised accounting standards for a client that is:  
(A) a publicly traded company located, incorporated, or doing business in California,  
(B) a government agency located in California; or  
(C) any other entity where disclosure of the financial statement is required by law and the entity is incorporated, located, or doing business in California.

This alternative was rejected because the Board concluded that this language was confusing and restatements correcting errors were of primary interest to the Board.

- The Reforms Statutes Implementation Task Force considered the following alternative for Section 60:

Section 60. Reporting of Investigations by the Public Company Accounting Oversight Board.

For purposes of reporting pursuant to Section 5063 (b)(5), notice of the opening or initiation of an investigation by the Public Company Accounting Oversight

Board shall include any notice by the Public Company Accounting Oversight Board that it is initiating an investigation of the licensee or any associated person of the licensee in connection with any services performed by the licensee or the associated person.

This alternative was rejected because use of the term “associated person” without a definition was considered confusing. Revised language incorporating a definition of “associated person” was recommended to the Board and received the Board’s approval.

- The Reform Statutes Implementation Task Force considered the following alternative language for subsection (b) of Section 61.

(b) To meet the reporting requirements of subdivision (c) of Section 5063, licensees shall report judgments consistent with that provision that are the result of actions brought by clients located, residing, or doing business in California.

This alternative was rejected because the Task Force concluded it was appropriate to only require the reporting of judgments alleging negligent conduct when a person residing or doing business in California is a party to the action and the alleged conduct relates to the practice of public accountancy in California. The reasons for this conclusion are stated in the discussion of the factual basis for Section 61 above. The Board concurred with the Task Force’s conclusion.

- The Reform Statutes Implementation Task Force considered the following alternative language for Section 68.2:

68.2. Components of Audit Documentation.

(a) Audit documentation shall include, but not be limited to, the following:  
(1) the objectives, scope, and methodology, including any sampling criteria used;  
(2) documentation of the work performed to support significant conclusions and judgments, including descriptions of transactions and records examined that would enable an experienced auditor to examine the same transactions and records; and  
(3) evidence of any supervisory reviews of the work performed.

(b) To provide for the identification of audit documentation, audit documentation shall include an index or guide to the audit documentation which identifies the components of the audit documentation. Audit documentation shall include the date the document or working paper was completed by the preparer(s) and any reviewer(s), and shall include the signature or initials of the preparer(s) and any reviewer(s).

This alternative language was rejected in favor of the language in this proposal which substitutes “reviewer with relevant knowledge and experience, having no

previous connection with the audit engagement,” for the words “experienced auditor” in paragraph (a)(2). The Task Force concluded the new language is clearer, more comprehensive, and more consistent with the provisions of Business and Professions Code Section 5097. The Board concurred with the Task Force’s conclusion.

In subsection (b), the Task Force substituted “identity” for “signature or initials” to more clearly provide for electronic documents. The Board concurred with the Task Force’s conclusion and made only a minor editorial change to the language recommended by the Task Force.

- The following alternative language for Section 68.3 was considered by the Reform Statutes Implementation Task Force:

68.3. Retention Period for Audit Documentation.

(a). The retention period by mandated by Business and Professions Code Section 5097 shall be measured from the date the auditor’s report is signed. If there are related reports, the retention period mandated by Section 5097 shall be measured from the date of the latest-issued report.

(b) If audit documentation is required to be kept for longer than seven years because of a pending Board investigation or disciplinary action, audit documentation shall not be destroyed until the licensee has been notified in writing by the Board of the closure of a Board investigation or disciplinary proceeding.

The language in Subsection (a) was rejected in favor of similar language that substituted “report date” for “date the auditor’s report is signed” as the Task Force concluded that term would be better understood by licensees.

The Task Force also added a new subsection (c) to clarify that all documents must be maintained in accessible form.

The Task Force presented the following alternative language for subsection (a) of Section 68.3 to the Board:

(a). The retention period by mandated by Business and Professions Code Section 5097 shall be measured from the date the auditor’s report is signed. If there are related reports, the retention period mandated by Section 5097 shall be measured from the date of the latest-issued report.

This alternative was rejected because the Board concluded that the concept of “related reports” was confusing and that deletion of the second sentence would enhance the clarity of this subsection.

- The Task Force considered the following language for Section 68.4:

68.4. Changes in Audit Documentation After Issuance of the Report.

(a) Changes in audit documentation include any addition, removal, deletion, substitution, or editing of audit documentation, including, but not limited to physical or electronic additions to any audit documentation file or preexisting audit documentation, occurring after issuance of the audit report which is supported in whole or in part by the audit documentation.

(b) In addition to any other documentation required by professional standards, any changes to audit documentation shall include the identity of the person(s) making the change, and identity of any person(s) approving the change, the reason for the change, and the date of the change. The documentation which is changed shall contain sufficient detail to enable a reviewer with relevant knowledge and experience, having no previous connection with the audit engagement, to understand the nature, timing, and extent of the change.

The language in subsection (a) was rejected in favor of language that stated “date of the audit report” instead of “issuance of the audit report” because the revised language was believed to have greater clarity and consistency with proposed Section 68.3.

The language in subsection (b) was rejected in favor of language that required documentation of the reason for the change in those instances when the reason was other than the assembling of pre-existing documents. It was concluded that this revision would ease compliance with the requirement. The Board concurred with the Task Force’s conclusion related to subsection (b).

The Task Force recommended to the Board the following language for subsection (a) of Section 68.4.

(a) Changes in audit documentation include any addition, removal, deletion, substitution, or editing of audit documentation, including, but not limited to physical or electronic additions to any audit documentation file or preexisting audit documentation, occurring after the date of the audit report which is supported in whole or in part by the audit documentation.

The Board modified this language by changing “date of the audit report” to “date of issuance of the audit report.” It was noted that the term “report date” refers to the date the audit field work is completed, while “date of issuance” refers to the date the report itself is released. It was concluded that the “date of issuance” was more appropriate in this subsection. Also, the Board added a new subsection (b) to require that audit documentation include both the report date and the date of issuance of the report. The previous subsection (b) was re-lettered as subsection (c).

The Reform Statutes Implementation Task Force considered the following alternative language for subsection (b) of proposed Section 68.5:

(b) This policy shall provide for the custody, security, authorized access, and destruction of the documentation. This policy shall, at a minimum, include the following:

(1) procedures for the maintenance of back-up copies of audit documentation at secure locations,

(2) procedures for maintaining audit documentation,

(3) procedures for approving any changes to audit documentation,

(4) procedures for approving the destruction of documentation when no longer required to be maintained by Business and Professions Code Section 5097.

The Task Force concluded that, in order to ease compliance with the requirement, it would be appropriate to require the maintenance of back-up copies of electronic (but not paper) records. The Board concurred with the Task Force's recommendation.



## Attachments

Attachment 1  
Assembly Bill No. 270

Attachment 2  
Senate Bill No. 1955

Attachment 3  
California Board of Accountancy, Reform Statutes Implementation Task Force,  
Minutes of Meeting  
***(Please call Aronna Granick at (916) 263-3788 for a hard copy.)***

Attachment 4  
Accounting Standards, Current Text, Volume I, General Standards  
***(Please call Aronna Granick at (916) 263-3788 for a hard copy.)***

Attachment 5  
Organizing the Audit and the Workpapers  
***(Please call Aronna Granick at (916) 263-3788 for a hard copy.)***

Attachment 6  
Assembly Bill No. 2873

Attachment 7  
Statement on Standards for Continuing Professional Education (CPE) Programs  
***(Please call Aronna Granick at (916) 263-3788 for a hard copy.)***

Attachment 8  
California Board of Accountancy, A Manual of Disciplinary Guidelines and Model  
Disciplinary Orders, 5<sup>th</sup> Edition, 2003  
***(Please call Aronna Granick at (916) 263-3788 for a hard copy.)***